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State Considers Allowing Co-Sponsorship of Hospitals by Out-of-State Health Systems

In his Health Law column, Francis J. Serbaroli of Greenberg Traurig, LLP discusses the laws and regulations governing the control of New York's numerous not-for-profit hospitals and hospital systems. He reports that New York's Public Health and Health Planning Council is considering allowing out-of-state not-for-profit hospital systems to become the co-operator of hospitals in New York.

By Francis J. Serbaroli | September 21, 2018 | New York Law Journal

As we have mentioned in many of these columns, hospitals and other health care facilities in New York state are subject to a complex legal and regulatory system. Most hospitals in the state are not-for-profits or government sponsored. Although some hospitals in New York have operations in other states, only a few hospitals are affiliates or subsidiaries of out-of-state hospital systems. Ownership of a hospital by a publicly-traded hospital operator is effectively prohibited by law. N.Y. Public Health Law (PHL) §2801-a(4)(d)-(e). Where once there were many physician-owned for-profit hospitals throughout the state, there are few, if any, for-profit general hospitals left, and none in New York City.

In an important development, the New York State Department of Health (DOH), which licenses and regulates general hospitals, is considering allowing the co-sponsorship of not-for-profit hospitals by out-of-state not-for-profit systems. This column will discuss hospital governance in New York and what this new development may entail.

Background

Over the past 30 years, the health care landscape—especially in New York—has undergone a profound transformation. Where once there were many independent hospitals that were run by and for their local communities, many hospitals are now part of larger systems that provide services over broad swaths of the state. Many factors are responsible for these consolidations, including the implementation of the Affordable Care Act, government efforts to rein in Medicare and Medicaid expenditures, increased competition, newer modalities of care, declining inpatient hospitalizations, and other trends.

The typical model for these large systems consists of a not-for-profit parent corporation or foundation sitting atop one or more licensed facilities, such as hospitals, clinics, ambulatory surgery centers, nursing homes, etc. Up until now, these parent corporations have fallen into one of two categories defined by the DOH as either "active" or "passive."

A passive parent entity is supposed to have limited powers over a licensed entity such as a hospital. Typically, a passive parent serves as the corporate member, appointing members of the hospital governing board, approving amendments to the hospital's certificate of incorporation and corporate bylaws, recommending the adoption by the hospital of policies and procedures, participating in the development of strategic plans, reviewing the hospital's budget, and approving any merger, affiliation, or dissolution. A passive parent does not have to be "established" (i.e., formally authorized, licensed and regulated as a hospital operator) under PHL Article 28.

Most large systems, however, are active parents with the ability to exercise significant control over their hospitals, and to take actions and implement programs, policies and procedures for accomplishing system-wide goals. An active parent must be established under Article 28 of the PHL since it is considered as the operator or co-operator of its hospitals.

Establishment

PHL Article 28 governs the establishment and regulation of general hospitals, diagnostic and treatment centers, ambulatory surgery centers, nursing homes, hospices, public health centers, and certain other health and dental facilities that the PHL collectively refers to under the term "hospital." PHL §2801(1). In order to establish such a facility, the proposed operator must file a lengthy certificate of need (CON) application with the DOH. The CON application is reviewed by DOH staff according to criteria such as financial feasibility, the character and competence of the applicant(s), the need for such a facility in the community, and other factors. The DOH staff then prepares its recommendation and forwards the application to the Public Health and Health Planning Council (PHHPC) of DOH. The application is first reviewed by the PHHPC's Establishment and Project Review Committee. The Committee issues its recommended action (e.g., approval, approval with contingencies, disapproval, postponement), and the application then is acted upon by the full PHHPC.

CON approval must be obtained for the establishment of any hospital, and to file the certificate of incorporation of any business or not-for-profit corporation or articles of organization for any limited liability company whose purpose is to establish or operate a hospital, or solicit contributions for such purpose. PHL §2801-a(1). In addition, CON approval is required for a change in the operator of a hospital. PHL §2801-a(4)(a).

Under DOH regulations, an Article 28 hospital must maintain management control over its operations. 10 NYCRR §§405.2—405.3. This mandate is also reflected in 10 NYCRR §600.9(2) which states:

(1) Except as provided in §405.3 of this Title, the governing authority or operator may not contract for management services with a party which has not received establishment approval.

(2) The criteria set forth in this paragraph shall be used in determining whether there has been an improper delegation to the management consultant by the governing authority or operator of its responsibilities:

(i) authority to hire or fire the administrator or other key management employees;

(ii) maintenance and control of the books and records;

(iii) authority over the disposition of assets and the incurring of liabilities on behalf of the facility;

(iv) the adoption and enforcement of policies regarding the operation of the facility.

Thus, a hospital many not turn over control of its management to a party that has not received PHHPC establishment approval. Accordingly, if a parent entity seeks to exercise control over the management of a hospital, the parent must also be established under Article 28.

Control

Other regulations enumerate specific actions that constitute hospital operation. For example, 10 NYCRR §405.1(c) provides that an entity is an operator of a hospital if it has decision-making authority over any of the following:

(1) appointment or dismissal of hospital management-level employees and medical staff, except the election or removal of corporate officers by the members of a not-for-profit corporation;

(2) approval of hospital operating and capital budgets;

(3) adoption or approval of hospital operating policies and procedures;

(4) approval of certificate of need applications filed by or on behalf of the hospital;

(5) approval of hospital contracts for management or for clinical services; and

(6) approval of settlements of administrative proceedings or litigation to which the hospital is party, except approval by the members of a not-for-profit corporation of settlements of litigation that exceed insurance coverage or any applicable self-insurance fund.

If a parent corporation satisfies these criteria or is otherwise found to have “active” control in these areas, it will be considered an operator, and therefore must seek Article 28 establishment approval to operate its hospital, nursing home or other Article 28 facility. Moreover, any management contract with an Article 28 licensed facility must be submitted for approval by the Commissioner of the DOH. 10 NYCRR §405.3(f).

The regulations also prohibit the sharing of revenues for providing medical services between an Article 28 hospital and any other person or entity:

An individual, partnership or corporation which has not received establishment approval may not participate in the total gross income or net revenue of a medical facility. 10 NYCRR §600.9(c).

Therefore, if an Article 28 hospital shares any of the revenue that it receives for health-related services with its corporate parent, the parent must also be established under Article 28. That is to say, a parent corporation must be established under Article 28 as a hospital operator if it intends to share in the revenues of any of its affiliated Article 28 licensed entities.

Co-Sponsorship

DOH, in a Sept. 13, 2018 outline entitled "Establishment Models," states that there have been requests by "certain entities" that the DOH and PHHPC allow "limited establishment" in certain circumstances of national hospital operators in order to allow the national entity to infuse resources into New York hospitals, share in those hospitals' revenue, and "exercis(e) certain powers that they believe they can use to contribute to the long-term sustainability of the local co-operator." The DOH outline notes that only the PHHPC would be able to permit limited establishment powers, citing PHL §2801-1(10) which requires that:

The [PHHPC], by a majority vote of its members, shall adopt and amend rules and regulations, to effectuate the provisions and purposes of this section, and to provide for the revocation, limitation or annulments of approvals of establishment. (DOH emphasis.)

DOH also cites as authority 10 NYCRR §405.2(b), which requires that:

The hospital shall have a governing body legally responsible for directing the operation of the hospital in accordance with its mission. If a hospital does not have an organized governing body, then the person or persons legally responsible for the conduct of the hospital shall carry out the functions … that pertain to the governing body.

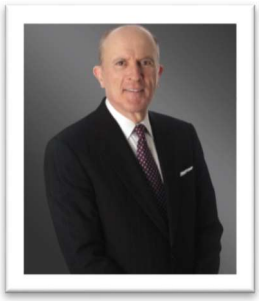
Under current law and regulation, establishment as an Article 28 hospital or active parent is plenary establishment. That is to say, the established entity has the authority—and the responsibility—to operate a hospital whether or not it actually is the day-to-day operator of a hospital. What the DOH is proposing is creating a new category of "limited establishment" whereby the domestic active parent of hospitals in New York would remain a fully-established co-operator of its Article 28 hospitals, while the out-of-state entity could obtain limited establishment approval to be a co-operator of the same hospitals. The DOH outline states that this limited establishment status would allow the out-of-state entity to be the co-operator of hospitals but only liable in turn for the portion of the establishment power of 10 NYCRR §405.1(c) that it agrees to share with the domestic active parent, and that are approved by the PHHPC.

In essence, what DOH and PHHPC are considering is allowing out-of-state not-for-profit hospital systems to become established on a limited basis as a co-operator of hospitals or hospital systems in New York. The out-of-state system would then be able to infuse capital into the hospitals and otherwise provide them with financial and strategic support. It would also allow the system to participate in the revenue of those hospitals. It must be emphasized that DOH is not considering allowing publicly-traded hospital corporations to own hospitals in New York, which in any case would require the Legislature to amend the PHL.

The DOH outline has been presented to and will now be considered by PHHPC. The discussions and any ultimate decision by the PHHPC will be closely followed.

About the Author:

Francis J. Serbaroli *is a shareholder in Greenberg Traurig and the former vice chair of The New York State Public Health Council.*



Francis J. Serbaroli
SerbaroliF@gtlaw.com